26 July 1985

NOTE FOR: Bill Martin, Executive Secretary, NSC

FROM: David B. Low
National Intelligence Officer for Economics

SUBJECT: Initiatives for the NSC

1. In response to your request, I put together (very informally--personal views only) the following list of issues that the NSC might tackle in an NSSD format, either at its own ititiative or because of events, over the next twelve months.

2. Aside from the more obvious issues I listed, you might consider tackling the question of the dollar, our trade deficit with Japan, and the eroding trade surpluses of debtor LDCs. If you believe, as many argue, that the US current account deficit is roughly set by our need to import foreign capital, then we should give more thought to the direction of the largess created by this deficit. The penchant for European countries to use monetary policy to temper the movement of their currencies vis-a-vis the dollar and of LDCs to peg to the dollar means that most of the changes in our deficit must be reflected by trade with Japan. The current policy of lowering interest rates in part to bring the dollar down and help trade does little to alter this imbalance since the LDC currencies and, to a lesser extent, the European ones, will follow the dollar.

3. Another course would be to bring the dollar down by selectively allowing more imports from favored LDCs and indirectly reducing our deficit with Japan. To some extent we are already doing this de facto with the CBI and our free trade agreement with Israel. I think we could do more, however, by looking more at the Latin countries.

4. This is a particularly good time to take an initiative in this area.

- o We are considering a new GATT round which, absent major progress on services, will do little for US interests.

- o We are also considering an extension of the MFA, an agreement which works to the detriment of many friendly debtors.

- o Also, the decisions of Latin countries to limit devaluations in order to hold down inflation portends real problems in the future.

5. The problems with this idea are, of course, even more compelling.

- o The abstruse nature of the argument that financial deficits determine trade balances.

- o The individual interests that would be affected by selectively allowing more imports from favored LDCs.

Obviously you can never get agreement that financial deficits cause trade deficits. It is possible, however, to widen our bilateral trade initiatives with major debtors, perhaps even parallel with GATT negotiations, to bring about the desired result.

David B. Low

Attachment:
List of Issues

Sanitized Copy Approved for Release 2010/05/05 : CIA-RDP87T00759R000100100003-3

 25X1

Initiatives for the NSC

1. Key Debtor Countries: I sense an erosion, although not necessarily a fatal one, in the current system of ad hoc debt negotiations. For one, the current governments in Brazil and Mexico seem less in control of events than most analysts anticipated several months ago. Sarney, in particular, seems wed to a populist policy and may be vulnerable to demarches on debt moratoria if his policies fail. Also, I'm less sanguine about global growth and, hence, the environment for trade improvement in these countries. There is, at a minimum, a growing downside risk on the OECD growth front. Lastly, I'm concerned about the real currency appreciation that has taken place in these countries which has eroded the trade cushion which benefited them last year. We are, by the way, in the early stages of formulating a special estimate on this issue.

2. Mexico: The Mexican situation is particularly troublesome. The one major plus the government had going for it--the ability to rule strongly and take decisive economic and political action--seems to be eroding. This erosion coupled with the prospects for lower oil prices, devaluation of the peso, IMF confrontation, and the growing concerns of businessmen in the northern areas portends a possible substantial increase in friction with the U.S. both in economic areas and in emigration.

3. West European Energy Dependence: As you are aware, the Soviet Union is taking a more aggressive approach to pricing natural gas than they have in the past. This comes at a time when projections for future gas use in Western Europe may be near an ebb because of the national currency cost of imported oil and an extended period of sub-par economic growth. You have been as close to this issue as anyone in the government and know the problem well. Perhaps there are still untapped ways of spotlighting the problem in a more convincing way.

4. Israel and Egypt: I am also concerned that two largest aid recipients seem bent on courting economic disaster. In Israel, a lack of economic leadership could eventually drain the country of the very resource base that has been the backbone of the country's strength in the past. If oil prices fall, and Egypt suffers also, it will alter substantially two pillars of our political policy in the Middle East. I am aware that State Department has been playing an active role in trying to get Israel back on track. Perhaps NSC could also review the bidding in an analytic and policy sense, however, to develop a coordinated approach to the problem.

25X1
25X1

Sanitized Copy Approved for Release 2010/05/05 : CIA-RDP87T00759R000100100003-3

5. Falling Oil Prices: I believe we are underestimating the effects falling oil prices could have on the stability of friendly oil exporters simply because it is analytically difficult to do more than extrapolate present trends in internal political strains. There is already a good deal of tension among the ruling elements in Saudi Arabia. Whether the Saudis continue to play the role of swing producer or strike out on their own, these tensions are likely to increase with results that are impossible to determine. I am concerned that taken together with the problems in Israel and Egypt, we may be on the verge of suffering a relative loss of our political leverage vis-a-vis more radical elements in the area and, by extension, the Soviet Union. We have underway an estimate on this topic.

[redacted] 25X1

7. Pacific Basin: Clearly, events are moving rapidly on the Pacific rim. Japan may be on the verge of a new political system for changing Prime Ministers. Economically, the country (save for exports) is in the doldrums and in need of imaginative leadership to get the domestic economy going. China's prioritization of light industry and agriculture are obviously extremely important but, as yet, not well understood moves; and there is the sense of some movement on the Korean issue, although just what changes will result are not clear.

On the economic front, I am, as others, struck with the potential for a Pacific dialogue, but I find it as difficult as others to define this in useful terms. The complementarity and contrasts between the Asian and Latin economics are striking. In the past, bilateral forays by Asia into Latin America have foundered on the rocks of unwise heavy industrial projects that have not panned out. Perhaps there is another level to get an economic exchange going--managerial, other services, light industry or whatever--that could bring about a successful economic interchange between Asia and the Americas.